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"Improving the Combat Edge Through Outsourcing"

**Address of
The Under Secretary of Defense for Acquisition and Technology
Dr. Paul G. Kaminski
to the
Atlanta XXII Conference
Atlanta, Georgia**

April 24, 1996

It's a great pleasure to be with you and share my views on how the Department of Defense plans to take advantage of outsourcing and competition to improve readiness, generate savings for modernization, and improve the quality and efficiency of support to the warfighters.

BIG PICTURE TRENDS

First, let's look at some big picture trends. Our success in ending the Cold War has ushered in sweeping changes to the Department of Defense. The United States no longer faces a long and protracted conflict with a rival superpower. Instead, we must be prepared to fight and win two nearly simultaneous regional conflicts.

These conflicts are often described as "come as you are" wars, meaning that there will be little lead time for mobilization or surge of production capability. They will require rapid transportation, tailored and flexible maintenance support, and greater reliance on private sector suppliers.

These conflicts will be technology intensive. Technology has improved our lethality, precision, and mobility. As a result, victory will require dominating flows of information and communication.

As our warfighting scenarios have changed, so too have attendant support functions. Best business practices, tempered by risk and threat assessments, must be used to determine where outsourcing, privatization, and competition can improve the performance of these activities.

With the end of the Cold War, the Department of Defense has tailored its force structure and budget to meet the changed security threats. DoD's force structure today is roughly one third smaller than it was in the 1980s. Our budget has also declined about one third. In FY 1997, DoD's budget amounts to \$243 billion. Within this budget, the Department must meet three challenges:

First, we must sustain readiness. During this drawdown of forces and budget,

the Department provided full funding for readiness. The Department's actions ensured that U.S. forces have remained ready and prepared to defeat any adversary and perform required missions to meet our national security objectives. As the drawdown comes to an end, readiness indicators remain high.

Second, we must maintain and improve the quality of life for our military personnel. Quality of life is a paramount ingredient to attracting and retaining a dedicated, motivated force. The Department recognizes that a broad spectrum of services is required to meet the needs of service members and their families. The Department has therefore placed a high priority on ensuring that our personnel are adequately paid, housed, and otherwise supported.

Third, we must pursue needed modernization. The U.S. armed forces are the best equipped in the world. As the Department's overall budget fell in the past decade, DoD reduced resources allocated to the purchase of new equipment and the modification and upgrade of existing systems. Between 1985 and 1996, the procurement budget declined by about 68 percent in real terms. In FY 1996, the Department's procurement budget totaled \$43 billion.

This reduction in the procurement budget came at little risk to our fighting forces. In fact, the Armed Services were able to maintain the average age of most weapons in the hands of the fighting forces, even though they bought fewer new systems, by discarding their oldest equipment and redistributing newer equipment throughout the smaller force structure.

NEED FOR MODERNIZATION

This process is ending, and new equipment must be purchased. In addition, new technologies are now emerging that will dramatically increase the capabilities of our forces. In the coming years, therefore, the Department must modernize its forces.

We need to be concerned with measuring the output of — not just the input to — our modernization program. BRAC, by freeing up funding for procurement, provides resources to increase the input. The initiatives you have heard about in acquisition reform are taking root. They are already improving the output. Privatization and outsourcing improve both the input and output.

The commitment to reduce the federal deficit to zero by the year 2002 means that the Department cannot responsibly plan its future budget needs with the expectation of a significant sustained increase in its real "top line." Solutions to our funding challenge must be found within our current and projected budget topline. To this end, DoD has initiated a series of initiatives to increase the efficiency of its operations in order to gain more value for every dollar expended.

The Department has significantly reduced infrastructure costs through the base realignment and closure, or BRAC, process. In FY 1996, the BRAC budget crossed over from a net loss on DoD budgets to a net surplus. Over the next five years, BRAC will generate net savings of \$17.8 billion. We estimate that the results of the four rounds of base closures and realignments, when fully implemented, will produce annual savings of about \$5.5 billion.

As you know, the Department has also initiated a thorough reform of the acquisition process. Over the years, numerous blue ribbon panels and commissions have proposed reforming the defense-unique, slow-moving, and thus expensive, acquisition system. Today, we are implementing those changes. The Federal Acquisition Streamlining Act of 1994, the Federal Acquisition Reform Act of 1996, and the recently-signed DoD Directive 5000.1 and DoD Regulation 5000.2 will enable significant changes to DoD's procurement of goods and services. These initiatives, now in place, are beginning to show results and will lead to substantial efficiencies and savings in the future.

In addition, the Department is now beginning a systematic review of its support operations to determine where competitive forces can improve overall performance at lower cost. Outsourcing, privatization, and business reengineering offer significant opportunities to generate much of the savings necessary for modernization and readiness. It is this third major initiative—creating efficiencies in our support operations—that I would like to concentrate on today.

IMPORTANCE OF COMPETITION AND OUTSOURCING

DoD can free up additional resources required for modernization in the future by managing its internal operations and particularly its support activities more efficiently. Support activities, broadly defined, represent a sizable portion of the defense budget. These activities were largely established and organized during the Cold War when DoD had to depend predominantly on organic support.

Like the best companies and organizations in the United States, DoD has embarked on a systematic and vigorous effort to reduce the cost and improve the performance of its support activities.

Outsourcing, privatization, and competition offer the prospect of lowering costs and improving performance across a wide range of support activities. The Department's total budget for operation and maintenance activities in FY 1996 amounts to approximately \$93 billion. Support activities will only be considered for outsourcing or privatization when they meet three conditions:

First, private sector firms must be able to perform the activity and meet our warfighting mission. DoD will not consider outsourcing activities that constitute our core capabilities.

Second, a competitive commercial market must exist for the activity. DoD will gain from outsourcing and competition when there is an incentive for continuous service improvement.

Finally, outsourcing the activity must result in best value for the government and therefore the U.S. taxpayer. Activities will be considered for outsourcing only when the private sector can improve performance or lower costs in the context of long term competition.

If done correctly, outsourcing will not only save us money, it will help us build the kind of organization we want DoD to be: an organization that thrives on competition, innovation, responsiveness to changing needs, efficiency and reliability.

As you know, we already outsource quite a bit. In aggregate, DoD currently outsources approximately 25 percent of base commercial activities, 28 percent of depot maintenance, 10 percent of finance and accounting, 70 percent of Army aviation training, 45 percent of surplus property disposal, and 33 percent of parts distribution, as well as substantial portions of other functions. Indeed, virtually every support function that the Department carries out is provided by the private sector at some location.

The Defense Logistics Agency's Direct Vendor Delivery and Prime Vendor programs illustrate the savings and improvements in readiness that DoD has achieved through business reengineering and outsourcing. Under these programs, suppliers deliver products directly to their DoD customers, rather than to a DoD warehouse for storage and subsequent distribution to the end user, such as a messhall. The programs have made a tangible contribution to readiness: reducing the need for DoD's own warehousing and transportation allows DLA to deliver supplies to warfighters cheaper and faster. In the case of pharmaceuticals, for example, DoD customers now receive their requested goods 75 to 90 percent faster—within 24 hours—and 25 to 35 percent cheaper. These programs not only save resources, but do the job better.

To generate the savings we need for modernization, we need to build on these successes. A broad based review of Department support activities is underway. We currently are focusing on base commercial activities, materiel management, depot maintenance, education and training, data processing, and finance and accounting.

These assessments will likely determine that a number of activities are not appropriate candidates for outsourcing or competition. However, the remaining pool of candidates will be sizable, and we expect that the potential for increased savings and

improved performance will be significant, amounting to billions of dollars on an annual basis.

The savings will directly benefit modernization. To make this connection clear and to provide appropriate incentives to the Military Departments, the Deputy Secretary of Defense signed a memorandum on February 26, 1996, stating that the DoD Components will not have their outyear budgets reduced as a result of the savings they create through their initiatives, and that these savings should benefit modernization.

I know that Army Chief of Staff Dennis Reimer has highlighted the importance of the Department's outsourcing initiative in a message to the commanders of the major commands. His message rightfully emphasizes the importance of tapping the knowledge and experience of commanders in the field, who know their operations, where efficiencies can be gained, and what priorities to place on seeking both efficiency and quality.

WHY OUTSOURCING AND COMPETITION WORK

Competition and outsourcing bring a number of advantages over business as usual.

Outsourcing can introduce competitive forces, which drive organizations to improve quality, increase efficiency, reduce costs, and better focus on their customer's needs over time. For DoD, competition can lead to more rapid delivery of better products and services to the warfighter, thereby increasing readiness.

Outsourcing can enhance management flexibility. Outsourcing provides commanders with flexibility to determine the appropriate size and composition of the resources needed to complete tasks over time as the situation changes.

Outsourcing allows organizations to take advantage of economies of scale and specialization. Firms that specialize in specific services generate a relatively larger business volume, which allows them to take advantage of scale economies. Often, these economies of scale mean that specialized service firms can operate and maintain state-of-the-art systems more cost-effectively than other firms or the government. Outsourcing to such firms provides a means for the government to take advantage of technologies and systems that the government itself cannot acquire or operate economically.

Finally, outsourcing fosters better management focus. In recent years, our nation's most successful companies have focused intensively on their core competencies -- those activities that give them a competitive edge -- and outsourced support activities. The activities that have been outsourced remain important to success, but are not at the

heart of the organization's mission. Business analysts frequently highlight the fact that the attention of an organization's leaders is a scarce resource that should be allocated wisely. This is equally true for the Department of Defense.

COMMITMENT TO SMALL BUSINESS

Before I summarize, I'd like to share a final note with you on the Department's commitment to small businesses as we outsource and privatize our support functions.

As you know, on October 23, 1995, the Department suspended use of the DoD unique Rule of Two set aside for small disadvantaged businesses (SDBs). To mitigate against the impact of this suspension on the Department's traditional fine record of support to the SDB community, I asked in a November 3, 1995 memorandum that certain actions be taken.

These actions included increasing use of the 8(a) program, increasing use of the small business set-asides and reviewing of requirements with a view to potential breakout in an effort to increase the ability of small businesses to successfully compete. In addition, I asked that you reenergize the use of small and disadvantaged business subcontracting as an evaluation factor in source selections and that incentives be included in contracts to reward prime contractors that propose and deliver on such proposals.

I am getting feedback which indicates that my request may not have filtered down to you. Let me be perfectly clear. I remain committed to the continued participation of small firms and in particular small disadvantaged business concerns in our acquisition programs as both prime and subcontractors. To this end, the new 5000.2 will include small business as part of the IPT process. Also, I would appreciate hearing from you on your successes in this area and of any lessons learned on how this objective may be best achieved.

SUMMARY

DoD must continue to reduce its infrastructure and support costs to increase funding for modernization in the coming years. Introducing the competitive forces of the private sector into DoD support activities will reduce costs and improve performance.

Outsourcing is not a theory based on uncertain assumptions. Experience in DoD and the private sector consistently and unambiguously demonstrates how the competitive forces of outsourcing can generate cost savings and improve performance. One need only glimpse at the operations of our nation's most successful companies to see the dramatic benefits that they realize through outsourcing and competition.

Through its outsourcing initiatives, DoD has begun a long-term effort to streamline its support functions further. The success of the Department's outsourcing initiatives today will help determine how well it supports our warfighters tomorrow.

Thank you all.